

**REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL
LEGISLATURE AND THE COUNCIL ON THE NELSON MANDELA BAY METROPOLITAN
MUNICIPALITY**

REPORT ON THE CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

Introduction

1. I have audited the consolidated and separate financial statements of the Nelson Mandela Bay Metropolitan Municipality set out on pages ... to ..., which comprise statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2013 (Act No. 2 of 2013) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these consolidated and separate financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated and separate financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated and separate financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated and separate financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated and separate financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Irregular expenditure

6. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. The irregular expenditure disclosed in note 44 to the financial at R768,5 million (2013: R483,3 million) was understated. Due to lack of systems, and non-availability of sufficient appropriate audit evidence for all awards, it was impracticable to determine the full extent of the understatement of irregular expenditure. Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure disclosure note.

Creditors - Exchange Transactions

7. The municipality did not have an adequate system in place to ensure that all vacation leave is properly administered. As a result sufficient appropriate audit evidence could not be obtained to confirm that the staff leave creditor of R144,7 million and the related employee cost expenditure, was correctly accounted for in terms of GRAP 25: *Employee Benefits*. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the related account balances and classes of transactions.

Qualified opinion

8. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the consolidated and separate financial statements present fairly, in all material respects, the financial position of the Nelson Mandela Bay Metropolitan Municipality as at 30 June 2014 and its financial performance and cash flows for the year then ended, in accordance with the in accordance with GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

9. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of comparative figures

10. As disclosed in notes 40 to the consolidated and separate financial statements, the comparative figures for 30 June 2013 have been restated as a result of a change in accounting policy and errors that were only corrected during the financial year ended 30 June 2014 but that existed in the separate financial statements of the municipality at, and for the year ended, 30 June 2013.

Unauthorised as well as fruitless and wasteful expenditure

11. As disclosed in note 44.1 to the consolidated and separate financial statements, unauthorised expenditure amounting to R743,9 million (2013: R270,8 million) was incurred during the current financial year due to overspending in respect of a number of votes within the approved municipal expenditure budget of which R640,8 million related to impairment of land and buildings.

12. As disclosed in note 44.3 to the consolidated and separate financial statements, fruitless and wasteful expenditure amounting to R10,9 million (2013: R2,6 million) was incurred during the current financial year mainly due to costs incurred due to retraction of a contract which could have been avoided had reasonable care been exercised.

Material losses

13. As disclosed in note 35.9 to the consolidated and separate financial statements, water losses amounting to R329,1 million (2013: R208,4 million) were incurred during the financial year.
14. As disclosed in note 35.10 to the consolidated and separate financial statements, electricity losses amounting to R234,7 million (2013 (R224,6 million) were incurred during the financial year.

Material impairments

15. As disclosed in note 28 to the consolidated and separate financial statements, the impairment of receivables amounted to R200,7 million (2013: R409,7 million) for the year.

Additional matter

16. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

17. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the consolidated and separate financial statements and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENT

18. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected development objectives presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

19. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development objectives presented in the annual performance report of the municipality for the year ended 30 June 2014:
 - Development objective 1: Basic Service Delivery and Infrastructure Development on pages XX to XX.

20. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
21. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
22. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
23. I did not raise any material findings on the usefulness and reliability of the reported performance information for the selected development objectives.

Additional matter

24. Although I raised no material findings on the usefulness and reliability of the reported performance information for the selected development or objectives, I draw attention to the following matter:

Achievement of planned targets

25. Refer to the annual performance report on pages XX to XX and XX to XX for information on the achievement of the planned targets for the year.
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Compliance with legislation

26. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance

27. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.

Annual financial statements

28. The consolidated and separate financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.
29. Material misstatements of expenditure, liabilities and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and/or the supporting records were provided subsequently, but the uncorrected material misstatements and/ or supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Audit committees

30. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.
31. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal planning and performance management regulation 14(4)(a)(iii).

Procurement and contract management

32. Sufficient appropriate audit evidence could not be obtained that measures to combat the abuse of the SCM system were not implemented as per the requirements of SCM regulation 38(1).
33. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e) and the code of conduct for staff members issued in terms of the Municipal Systems Act, 2000 (Act No.32 of 2000)(MSA).
34. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e) and the code of conduct for staff members issued in terms of MSA.
35. Awards were made to providers who are in the service of other state institutions or whose directors/ principal shareholders are in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulations 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).
36. Awards were made to providers who are in the service of the municipality and/or whose directors/ principal shareholders are in the service of the municipality in contravention of section 112(j) of the MFMA and SCM regulations 44. Furthermore the provider failed to declare that he/she was in the service of the municipality, as required by SCM regulation 13(c). Similar non-compliance was reported in the prior year and the municipality did not take disciplinary action against the suppliers/ officials involved.
37. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
38. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
39. Sufficient appropriate audit evidence could not be obtained that all extension or modification to contracts were approved by a properly delegated official, as required by SCM Regulation 5.
40. Sufficient appropriate audit evidence could not be obtained that contracts were only extended or modified after tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.

41. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.
42. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
43. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
44. Bids were not always evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services AND/OR at least one SCM practitioner of the municipality as required by SCM regulation 28(2).

Human resource management

45. An acting Chief Financial Officer (CFO) was appointed for a period of more than three months without the approval by the MEC for local government in contravention of section 56(1)(c) of the MSA.

Budget

46. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Expenditure management

47. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred and accounted for creditors and payments made, as required by section 65(2)(b) of the MFMA.
48. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Consequence management

49. Unauthorised , irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.
50. Unauthorised , irregular and fruitless and wasteful expenditure was not always recovered from the liable person, as required by section 32(2) of the MFMA.
51. The accounting officer and council did not always report to the South African Police Service cases of alleged irregular expenditure that constituted a criminal offence, as required by section 32(6) and 32(7) of the MFMA.
52. Appropriate action was not taken against officials and role players in the supply chain management system where investigations proved fraud , corruption, favouritism , unfair or irregular practice or failure to comply with the supply chain management system, as required by Municipal Supply Chain Management Regulation 38(1)(b).

53. Allegations of fraud, corruption, favouritism , unfair or irregular practice or failure to comply with the supply chain management system laid against officials and role players were not investigated by the accounting officer, as required by Municipal Supply Chain Management Regulation 38(1)(b).
54. Investigations were not instituted into all allegations of financial misconduct against officials of the municipality, as required by section 171(4)(a) of the MFMA.
55. Disciplinary proceedings were not instituted against officials of the municipality, when investigations warranted such a step, as required by section 171(4)(b) of the MFMA.
56. Cases of financial misconduct which constituted a crime were not always reported to the South African Police Service, as required by section 62(1)(e) of the MFMA.

Internal control

57. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on non-compliance with legislation included in this report.

Leadership

58. Leadership have not instituted all the disciplines necessary to enable effective oversight and monitoring that promotes efficiency and effectiveness in financial management and compliance with laws and regulations, thus not setting the correct tone or building a high performance environment that promotes accountability.
59. The number of repeat audit findings and increase in irregular expenditure due to supply chain management transgressions is due to the lack of consequence management being exercised by leadership as well as a lack of commitment by management to implement action plans to address internal and external audit recommendations.
60. A number of executive management positions as well as the city manager position were vacant for a significant period of time. The continued absence during the year under review of permanent senior officials to lead and guide the municipality compromised sound financial management and accountability. The majority of these vacancies have been permanently filled during current financial year. Due to their limited time in the positions, these officials have been unable to have an impact on the control environment.
61. The lack of stability in critical positions has contributed to leadership not providing effective oversight with regards to the implementation and monitoring of internal controls. The lack of instilling basic disciplines and providing a strong leadership tone to ensure sound financial management and compliance with laws and regulations has resulted in inaccurate and incomplete financial and performance reporting as well as contravention of laws and regulations.
62. A clear pattern of the political and administrative leadership's slow response to the audit messages and root causes is evident by the repeat findings in respect of irregular expenditure and non-compliance with laws and regulations.

63. It is anticipated that the appointment of new senior managers will provide fresh oversight over the directorates to which they are appointed. This indicates a continuous drive by the municipality to facilitate an improvement in the operations of the municipality.

Financial and performance management

64. The municipality did not consistently implement and monitor the required daily and monthly financial disciplines to ensure that transactions were appropriately recorded and reported, as required by the financial reporting framework. The lack of financial discipline and monitoring during the financial year resulted in key reconciliations and processing only being performed after the financial year-end, and led to numerous material adjustments required to the financial statements during the audit process.
65. Management did not adequately monitor the actions and outputs of officials throughout the year under review to ensure compliance with key legislation. In addition the awareness of SCM requirements amongst officials across all functional areas was not at the required level, as evidenced by the amount of irregular expenditure identified during the audit. There was inadequate documentation and records management to ensure that sufficient, appropriate audit evidence existed in the area of SCM.

Governance

66. A risk assessment has been conducted by the municipality however this process is not fully effective as repeat findings relating to the key risk area of SCM are anticipated and there are still instances of maladministration, alleged irregularities and fraud.
67. The recommendations made by internal audit and the audit committee were not adequately responded to, as improvements in the control environment did not resolve all control deficiencies identified. Consequently, recurring material non-compliance and misstatements in the financial statements have been reported.

Auditor-General

East London

8 December 2014



Auditing to build public confidence